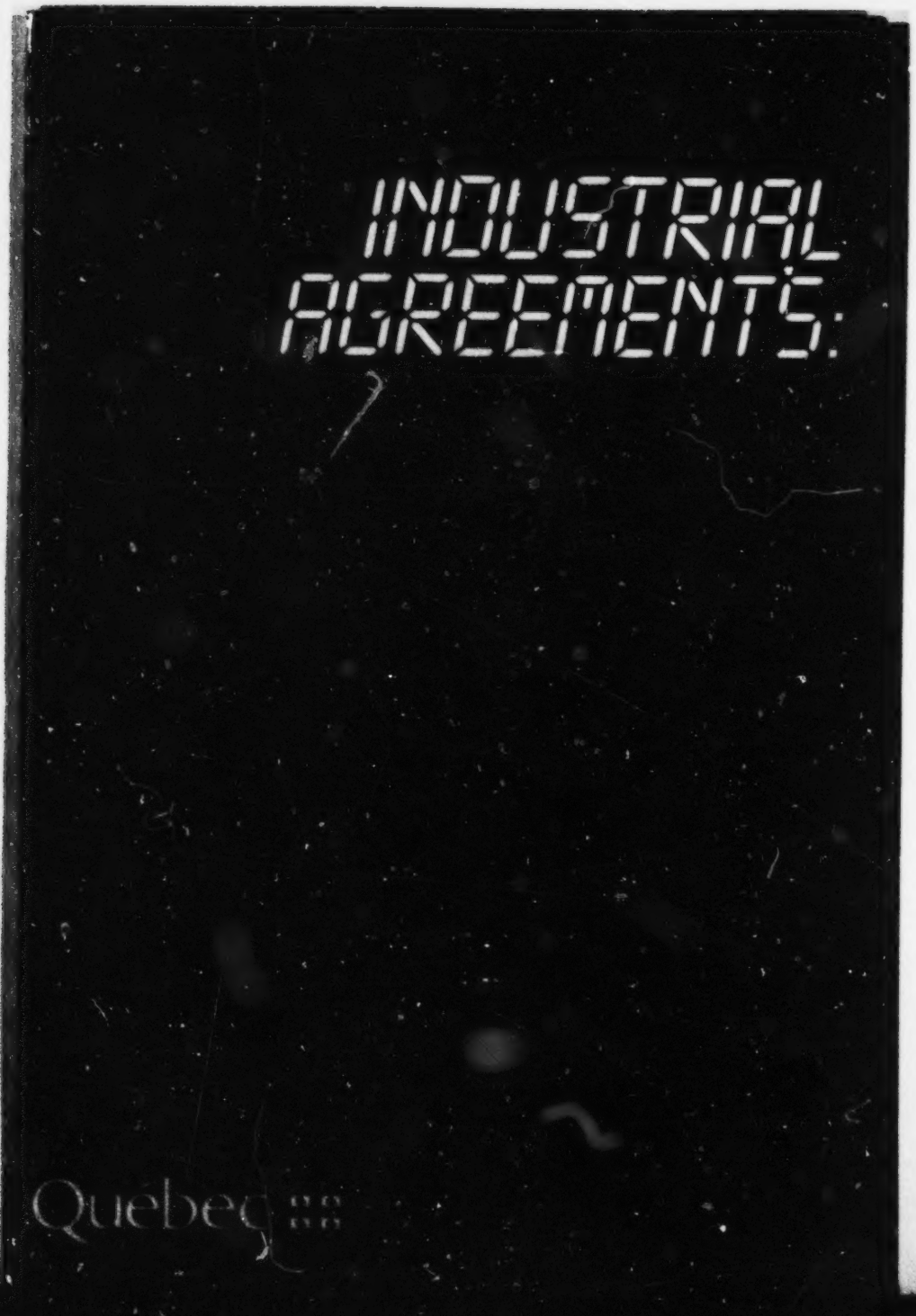
INDUSTRIAL
AGREEMENTS:
Quebec

INDUSTRIAL AGREEMENTS

Gouvernement du Québec
Ministère du
Commerce extérieur

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INTRODUCTION

How do we explain the fact that research and development of new products is, despite some progress, neglected by most companies? Why are decisions taken thoughtlessly when on the contrary they should be part of a rigorous planning process?

Several factors contribute to this situation:

- some businesses are too small to invest time and money in research activities of which the outcome is doubtful;
- managers are often too caught up by their routine to give much thought to the future of the company;
- they are often too easily satisfied with the quality of their products and the market situation.

However, it must not be forgotten that all high-technology industries can rapidly become outdated because all products eventually become obsolete.

This process, which has been the subject of numerous pieces of writing for the past thirty years, affects small and medium-size businesses as the larger ones. However, the consequences vary a great deal in each case.

Thanks to greater human and financial resources, large firms can cope more easily with technological changes that cause their products to become obsolete, either by adjusting their own techniques after intensive research, or by discontinuing an industry segment if no profitable economic solution is found, or finally by acquiring a manufacturing license for the new technology in question. They practically always have the time and means to find a solution.

On the other hand, small and medium-size businesses often rely on a few products and cannot allow themselves to undertake intensive research or to discontinue one or several products rendered obsolete by a technological innovation. Therefore, they are particularly vulnerable to technical changes, especially since they neither have the time nor the means to adjust to it.

The international technology transfer is one of the privileged means by which a company can avert this situation.

In the past, such transfers only occurred within firms holding interests in several countries. However, the rapid development of international trade relations and means of communication has helped to facilitate these transfers and to forget traditional restrictions. Access to this information is now available to all companies by assignment of a patent, licensing or franchising, provided that their management is concerned with the future and ready to stray from the beaten track.

This document deals only with industrial agreements and does not cover trademark licensing agreements[1], assignment of patents[2], franchising[3] or subcontracting[4].

A FEW DEFINITIONS

Patent

Title granted by the government within its own geographical area which gives the bearer a monopoly allowing him the right to interdict the manufacture, the sale and even the use of an invention for specified period of time. The patent is materialized by a title of industrial property which covers the invention and is granted to its owner.

Trademark

Any particular name or mark used as a mean of distinguishing the products and services of one source from those of all others. To ensure greater protection, it is preferable to register a trademark at the Trademark Office in Hull, by taking notice beforehand of those already registered or in current use.

Patentee or patent bearer

Entity who enjoys the advantages granted by a patent.

Assignment of a patent (or of a trademark)

Transfer to a third party, free of charge or for a fee, of the ownership of a patent and its applications (or the right to use a trademark). In general, such a transfer is final.

Licensing

Contract in which a bearer of a right (patent or trademark) leases this right to a third party on certain conditions. The license can be sole or plain, exclusive or non-exclusive, and accompanied or not with technical know-how.

Licensor or seller

Bearer of a patent, trademark, franchising technique, certain know-how, for example a non patented manufacturing process kept secret by its holder, who grants or sells it by contract to a third party (licensee or buyer).

1. A contract of this type covering the transfer of a trademark is often included in the negotiation of an industrial agreement, which may increase its cost.
2. Fairly rare sales agreement in which the patentee's ownership right is entirely transferred.
3. Franchising, which concerns the transfer of marketing methods, is often based on the reputation of a trademark.
4. It is a simple service contract by which a subcontractor agrees to manufacture capital goods according to an estimate: subcontracting and industrial agreement must not be confused.

Licensee or buyer

Entity to whom a license (sole or plain) covering a patent, trademark, secret manufacturing process or certain know-how, is granted.

Trademark license

Leasing agreement by which a bearer of a trademark authorizes a third party to use it.

Payment

Sum of money deposited to thc licensor by the person acquiring a patent or a certain know-how. It can take various forms.

Franchising

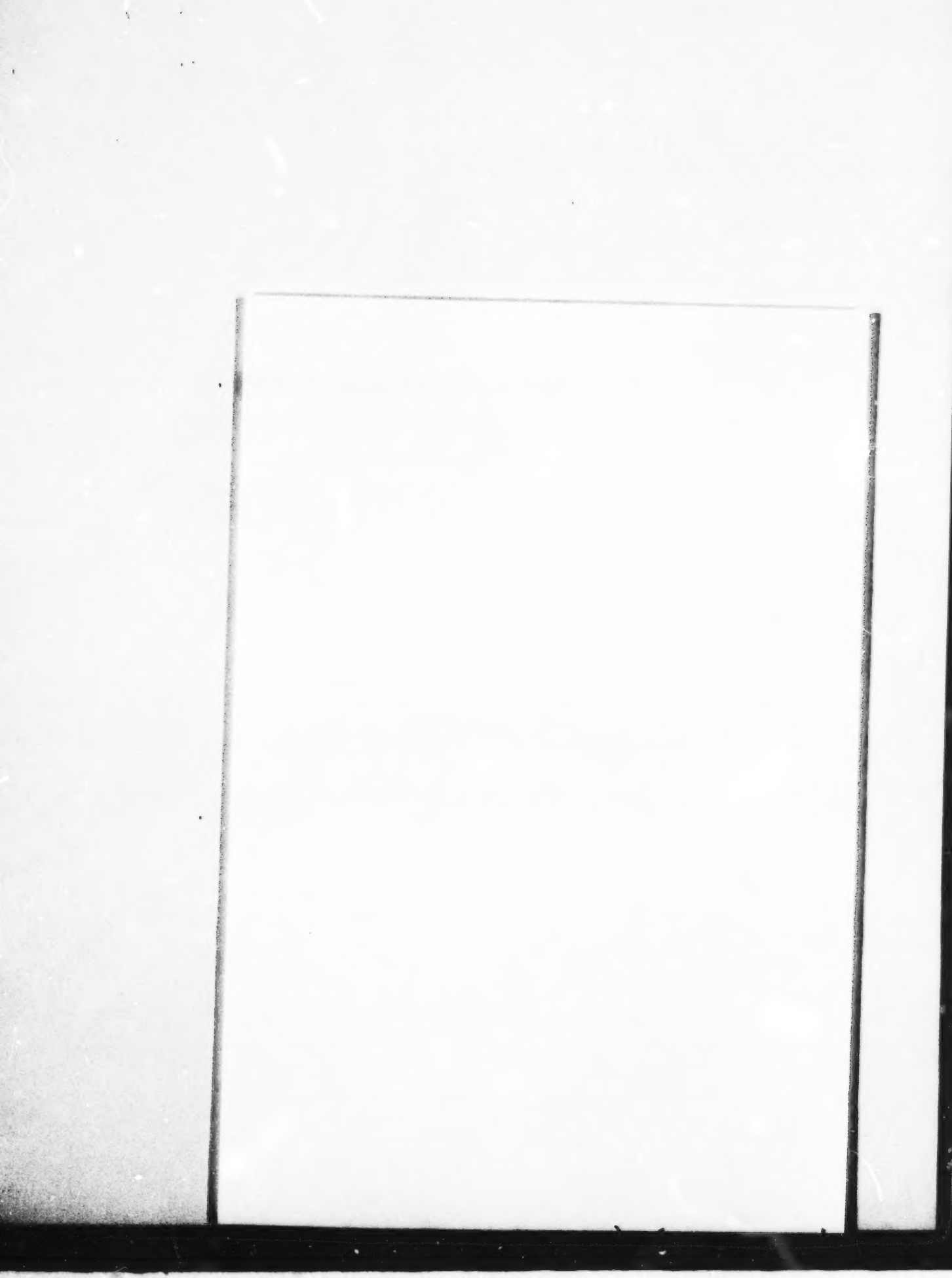
Grant of techniques or marketing (or management) methods relating to a particular product or service which allows to exploit it to the fullest.

Know-how

Sum of technical knowledge related to a manufacturing process or a product (patented or unpatented).

CHAPTER

1 OVERVIEW OF THE INDUSTRIAL AGREEMENT



Although the industrial agreement technique has been known for a long time, it is only in the early 1950s that companies started to recognize it as a means to develop foreign markets in the same way as exportation (but with a better penetration) or as direct investment (but at a lower cost).

Even though it expanded quickly during the 1960s, this means was not widely used by companies as recently as a few years ago. In fact, a study done by the Conference Board in 1969 with 118 American firms demonstrated that the industrial agreement was only a secondary working tool. I was used mainly to increase profits, or for subsidiaries or affiliated companies to benefit from a new technology.

Since then, the situation has changed a great deal: companies have understood the importance of developing new products, because traditional ones are becoming obsolete more and more rapidly. This is why more than half the products now available on the market did not exist ten years ago, moreover, this tendency is on an upward trend. This explains why, in Quebec as elsewhere, an increasing number of companies create special management teams responsible for the development of new products. Their role is to study the possibilities of manufacturing under license or of buying techniques, and to elaborate a process for the diversification of production.

Licensing is generally used for patented inventions or registered trademarks, but for the past few years agreements have been made on know-how or on non-patentable or secret innovations.

The contract which materializes this type of agreement often comprises other terms, for example:

- the exportation of raw material or equipment;
- the creation of a new company, in which the licensor provides the technology, and the licensee, the knowledge of the market, and where both parties commit funds;
- the exchange of know-how concerning other products or processes;
- the licensee's use of trademarks already related to the patent.

The preliminary negotiations are rather long. Since the parties are generally established in different countries, some difficulties arise because of the differences in language, mentality and value system. Thus, the delay can carry, but rarely is there a period of less than twelve months between the beginning of the negotiations and the signature of the contract. Furthermore, an additional six-month period must be anticipated to allow the licensee or buyer to put the product on the market. Therefore, the conclusion of a contract is not a short-term solution for a company in trouble; only good planning will enable the company to fully benefit from it.

Negotiations can be conducted by correspondence, through an expert, or by personal contact.

Contacts by letter are the least efficient ones. They do not allow a real dialogue and they are tedious and subject to errors or omissions.

Therefore, it is to the licensor's advantage to offer his product through the services of an intermediary such as an adviser from the Ministère du Commerce extérieur. This person carries out a preliminary research and favors the meeting of the partners which practically guarantees the success of the negotiations.

The Québec manufacturers who are interested in signing an industrial agreement must ascertain beforehand that the following conditions are fulfilled. Both partners must:

- have a similar technical expertise or, at least, be able to acquire the necessary competence after signing the agreement;
- have similar objectives regarding business development;
- have a good knowledge of their resources and their markets;
- succeed in establishing relations based on mutual trust;
- do a preliminary study of industrial ownership titles and their availability on the Canadian market.

However, these conditions are not sufficient and other factors must be taken into account, as will be shown in the next chapter.

CHAPTER

2 FINANCIAL, COMMERCIAL AND ECONOMIC ASPECTS OF INDUSTRIAL AGREEMENTS

This chapter deals with the financial, commercial and economic reasons that lead a firm to grant or conclude an industrial agreement.

1. FROM THE LICENSOR OR SELLER'S POINT OF VIEW

Financial reasons

An industrial research program, whether the research be basic or applied, is very costly. Therefore, it is normal that the main reason why a company decides to grant a license or to sell a technique should be a financial one: it wishes to share the cost with another party.

In order to protect efficiently a parentable invention, a company must file an application for a patent in its own country, and also everywhere where it wishes to exploit it or have it exploited, in other words in at least thirty countries. The filing and maintaining of all these patents require considerable expenses. The company cannot spread the various applications over a period of time because it is only entitled to a "12 month delay", according to the Paris Convention of 1884.

Since it cannot afford to exploit solely the world market, the firm will use the industrial agreement which is an excellent way to make the expenses profitable in countries where it has neither a subsidiary nor a distribution network.

Technology transfers between parent companies and subsidiaries often comprise financial terms. A remuneration of this kind represents an interesting aspect of a direct establishment abroad, all the more so since, despite some restrictions, the parent company has a great deal of liberty in fixing the price, and the terms of the transfer are very flexible and hardly restrictive, except in Latin America. In fact, it is rather hard to control the total amount since, beside the remuneration, the contract often provides for expenses for technical assistance, experts' travels, access to additional information, etc.

Furthermore, on account of the technological evolution, a patent holder may have to face rather soon the appearance on the market of a more sophisticated product developed by a competitor. He would rather grant the license, thus receiving royalties, than risk a decline in value of his patent, even if it means that the licensee might eventually become a competitor. However, this eventuality is less dangerous since license agreements generally provide for an exchange of know-how on the products or processes concerned, both parties being entitled to take advantage first of newly discovered applications. Finally, if the licensor does a lot of research, his own processes may become

obsolete. Therefore, it is advantageous to offset earlier research and development expenses by collecting royalties.

Another interesting aspect of the industrial agreement is to allow a company to circumvent certain governmental restrictions prohibiting or hindering foreign direct investments in a promising market. Japan is the best example. Until 1967, the only way to penetrate their market was either by exporting (difficult because of very low costs of local labour and of customs barriers), or by concluding agreements with Japanese firms. The latter solution was chosen in most cases.

Several countries are currently concluding such contracts in order to insure their industrial development, particularly the socialist countries, where it is difficult to export: signing agreements seems a good way to gain revenues which could not be obtained otherwise.

Moreover, the industrial agreement is less subject than exportations to disadvantages caused by the deterioration of the international monetary system. Generally, the remuneration is paid in the currency chosen by the licensor and the contract often provides for an adjustment in the event of a significant devaluation.

All these reasons explain the success of the industrial agreement. This success can be seen in various ways: several companies now possess important "patent portfolios" and consider the manufacturing license as a distinct source of profit that should be an integral part of their overall strategy. We are also witnessing in most of the industrialized countries the creation of several consulting firms specialized in seeking industrial partners who are interested in concluding such agreements.

Commercial reasons

By signing an industrial agreement, the licensor hopes to obtain relevant information on the local market, thus avoiding all the hazards of an establishment, especially if similar companies already settled do not look too favourably upon the arrival of a foreign competitor. By taking advantage of the licensee's distribution network and knowledge of the market, he is increasing, the chances of his products being accepted. Occasionally, the licensor will enter into partnership with the licensee, if the first results are encouraging and if the market proves to be steady. This system is often chosen because the licensee does not always have sufficient financial resources to develop adequate facilities and satisfy the local market demand. As for the licensor, he minimizes his risks and can consider exploiting the market in question on a larger basis by launching other products.

Canada offers another advantage to the foreign licensor. In fact, although the market seems rather limited at first glance, it can be an excellent place to test products that could eventually be exported to the United States.

From this point of view, the industrial agreement will be very beneficial not only to the Canadian company involved, but also to the economy of the country as a whole.

All in all, this sort of agreement can be used to develop sales abroad without investing a great deal of capital or hiring staff. The training of qualified personnel will be rather easy since there are adequate human resources within the local company.

Economic reasons

A patent holder can decide to grant a license because very high transportation costs make his products noncompetitive on foreign markets (this is especially true of very heavy products).

High customs duties sometimes prohibit the exportation of finished goods; however, the licensor can keep the right to supply semi-finished parts, thus offsetting certain investments which the licensee could not make profitable (ex.: moulds).

Numerous other economic, political and institutional reasons could be mentioned, for example: insufficient funds, political instability, differences in specializations (systems of measures), etc.

Finally, it should be noted that in most countries a patent must be exploited before a deadline (usually within three years), whether by the owner or one of the licensees. Otherwise, the owner could be obliged to grant licenses to interested third parties.

In summary, from the licensor's point of view, the industrial agreement seems like a good alternative to direct investment, especially when the licensee is located in a country where the environment, the value system, the human resources and the techniques are notably different from those in force in his own country. It considerably minimizes the risks of failure and rarely entails large investments in human or financial resources. Moreover, the financial return can be interesting and as for the exchange of technology, it can be very profitable for both parties.

2. FROM THE LICENSEE OR BUYER'S POINT OF VIEW

The main interest of such an agreement for the licensee or the buyer is that it will give him access to a new technology which has already been tested industrially abroad. He can choose products that will suit his production facilities or his distribution networks without having to incur large research expenditures.

He can also avoid the trial stage, since the licensor has already gone through that. Obviously, he will often have to modify the products to suit the local consumers' tastes, climatic conditions, standards in force, etc., but the basic innovation as far as the patent or the know-how is concerned will remain the same.

The industrial agreement is particularly advantageous for companies whose production facilities are either unused or not used to their fullest. In such cases, fixed costs inflate the production cost, making the company noncompetitive. The marginal costs of manufacturing new products under license will be rather low, and the firm will be able to improve its financial profitability and realize additional benefits.

The acquisition of a license or a technique will also enable a businessman to consider diversifying his production in a field he hardly knows, but where he detected some interesting business opportunities. He can then launch a strong attack against a competitor already established, knowing that he can offer a product of equal quality.

The Canadian buyer often obtains, aside from the possibility of exploiting a patent in his country, the right to export the product to the American market and even, in some cases, to other markets in the world. However, the royalties are then higher. It may even happen that the licensor invests a certain capital in the buyer's firm or in a new affiliated company. If so, the buyer risks losing the control of his own company, especially if the licensor is a multinational business firm.

In order to avoid this sort of problem, it is better to bring together parties who have similar financial resources. As long as the licensor is an independant inventor or a medium-size company, this danger is practically nonexistent. But in the last few years, most patents showing chances of success have been filed by companies equipped with big research centres. These companies have at their disposal quite a portfolio of patents. By buying one of those patents, the licensee obtains all the necessary information to exploit it, but as soon as he tries to develop closely related products which are not included in the agreement, he is liable to enter a field where the licensor already has some patents; he must either buy them, or obtain a license (unless he is capable of improving the product enormously in order to exchange know-how or licenses). As a general rule, it is far better to avoid these situations that can lead to the repurchase of the licensee by the licensor.

The negotiation of an industrial agreement always entails a certain amount of bargaining between the licensor and the buyer and each one of them must be able to highlight his own competence. For the licensor, the task is simple: he beholds the patents, hence a new technology. The buyer finds himself in a more delicate situation: he is seeking a business opportunity which would be difficult to obtain elsewhere since the patent precisely grants a

monopoly on exploitation. In exchange, he is offering the production facilities and a distribution network; but these assets could be obtained from other local manufacturers by the licensor, because seldom is there only one company on the market susceptible of manufacturing or distributing a given product. The balance of power is distorted from the start and the situation must not be worsened, otherwise we risk having a poor match and hinder the development of the local technology.

In Québec's industries which are favorable to this kind of agreement, these considerations limit to about 2,000 the number of companies liable to be interested. In many cases, a business employing about thirty persons is capable of signing agreements and maintaining relations with the licensor on an equal basis, as long as it has a good knowledge of the market and adequate manufacturing facilities.

However, in some fields, there are practically no sizeable Québec companies and it is very difficult to promote good agreements. The market is then supplied either by subsidiaries of foreign companies established in Québec, or by large importations of the products. On a short-term basis, the former is sufficient to meet the local needs, but it is not necessarily the best way to operate. Even if a new technology is proposed to these companies, they do not have, with a few exceptions, the power to make a decision on its acquisition and even less on its exploitation on the spot. The risk consists in seeing the technology reach the research laboratory of the parent company, and such a situation is not very satisfactory on a long-term basis.

Consequently, the decisions that will be taken regarding the acquisition or the refusal of the new technique will not be based on the advantages it can bring to Canadian markets in general and to the Québec one in particular, but they will depend on the company's own interest. For example, the purchase of the new technique can be refused due to recent investments. And even if it is accepted by the parent company, it is to be expected that our province will not benefit from it immediately. Even if there are one or several subsidiaries of foreign companies in the industry, the situation remains unchanged, for they all base their decisions on the same criteria.

Therefore, it is urgent to create a local market that could compete with the foreign firms already established here, while benefiting the economy of Québec as a whole. The signing of a license agreement is an excellent means to achieve that goal. By importing ideas, it is possible to act directly on the development process of a specific industry so as to accelerate it or to modify considerably the balance of power.

This is what was done in Japan: the manufacturers bought licenses or techniques in industries where the technology was just starting. They developed and improved it in order to surpass their associates and even to sell them new licenses or techniques. The Japanese manufacturers were mainly

interested in the following fields: electronics, optics, computers, tools, chemistry, ship building and synthetic materials. They are now able to sell an important number of licenses in Europe and the United States. In 1960, the Japanese industry purchased 25 licenses and sold one; in 1970, the ratio had fallen to 10 to 1 (7 to 1 from the financial point of view). The difference is still considerable, but we can expect it diminish when the agreements terminate and Japan continues to collect royalties on the techniques that will have been sold.

In cases where the market is supplied by imports, an industrial agreement is a means to replace them by a local production of equal quality, at similar or even lower costs, while the whole economy can benefit from a series of chain reactions (job creation, subcontracting, research, etc.).

The major problem consists in finding here companies or businessmen interested in such ventures. The answers lies in the shrewdness of Québec manufacturers as well as in governmental policies and attitude towards our dependency on "foreign suppliers". The creation in 1973 of the Direction des services internationaux within the ministère de l'Industrie, du Commerce et du Tourisme of the Québec government was the first step forward in this direction.

However, in order for Québec manufacturers to fully benefit from the opportunities that arise, it is essential that the candidate examines his financial, human and technical resources before signing such an agreement. He must also elaborate a development strategy for the fields in which he wants to operate, according to his current skills. It is only by defining his competence that he will be able to achieve a diversification by means of an industrial agreement.

Created in early 1983, the ministère du Commerce extérieur can help the manufacturers very efficiently by activating these various components. Services concerning the research and negotiation of industrial agreements are available. Its economic advisers working abroad can provide relevant information on the technology available on the world market. The organization of industrial missions on the occasion of various events (trade fairs, symposiums, exhibitions...) or of specialized technical missions in a given field (for example, visits to research centres, visits to interested businesses...) can help attain these objectives.

Therefore, in relation to the North American environment and value system, the industrial agreement represents an interesting and inexpensive economic developing tool.

However, it must be underlined at this point that the signature of such an agreement is neither a panacea nor an end in itself. From the time of the signature, it is essential that the buyer invest in research so as to trigger innovations and increase his power in view of future negotiations. Indeed, this

will allow him to gain access to other discoveries that cannot be acquired through a traditional license contract, but which are available through cross licensing. This subject will be dealt with in the following pages.

3. CROSS LICENSING AND EXCHANGE OF TECHNIQUES

It often happens that the two parties to an agreement carry out further research on the products or processes which are the subject of the contract in question. Generally, the contract stipulates that each associate must be the first informed of any application discovered by the third party, either free of charge or for a fee.

If the licensee is capable of sufficiently perfecting the product, he can obtain a patent granting him a certain monopoly and a significant power of negotiation. He can also avoid becoming too dependent on the licensor. It is only under this condition that small companies can embark, with few risks, in license agreements with larger firms. The main obstacle to this procedure is the lack of financial and human resources of "small licensees". A governmental research organism dedicated to helping small and medium-size businesses (like the Centre de recherche industrielle du Québec) can play an important role in this respect.

Cross licensing is also used by companies who are already equipped with a research centre and who own patents; by putting their patents together in a portfolio, they can exchange them as a whole for another series of patents in order to get established in a new field.

The assessment of the portfolio is fairly difficult and can only be done by experts. If there are important differences between the two portfolios being the subject of a transaction, financial compensations will be negotiated (often by a small acquisition of the capital).

Since our information is limited on this subject, it is difficult to quote exact numbers, but significant exchanges do occur between firms specializing in closely related industries. Since this practice is only the prerogative of a limited industrial population, it is hard to control the use of exchanged rights, and this occasionally leads to voluntary or unvoluntary abuses.

Especially in the chemistry industry, cross licensing is frequent. However, companies do not commit themselves under contract to have their associate benefit automatically from new developments. They prefer that each patent or addition be treated separately in order to keep their independence towards the information they want to acquire or convey.

It remains that obtaining a manufacturing license, whatever its value, represents only one step for the licensee. On a short and medium-term basis, even if this operation proves to be profitable, it still remains that the technique protected by that license will eventually become outdated. At that time, new negotiations will have to be undertaken. In order to be in a good bargaining position, it is essential that the licensee carries out a certain amount of research first. Such a decision must be taken rapidly: the research can be time-consuming and its success is often doubtful, but it directly conditions the future of the companies.

We will not go back to the Japanese example; however, we believe that they had a judicious approach which now allows them not to be totally dependent on foreign companies. Their results are there to prove it and it is an example worth keeping in mind to develop, on the one hand, the research of licenses for latest technologies and/or those still in the development stage and, on the other hand, to promote a research spirit in private businesses and in governmental agencies created with this end in view.

4. COSTS AND OTHER TERMS OF AN INDUSTRIAL AGREEMENT

We will now discuss the financial aspects of an industrial agreement and the other conditions to which the licensee or buyer must comply with in order to gain access to the licensor's technology.

Since each agreement is a special case, we do not have any exact numbers: costs can vary according to products, processes, companies and countries. Nevertheless, we will try to state some general principles to guide the persons who will sign the document. The parties will choose the modes of payment which are convenient to them and they can combine them as they wish.

A. PAYMENT

Lump sum payment

Generally, the licensor requires from the licensee or buyer a lump sum payment as evidence of his interest and to ascertain that the exploitation of the technology will continue. This amount also covers a portion of the research expenses and should be inferior to the cost of the research.

Royalties

In addition to this first disbursement, the contract generally provides for royalties. They are usually determined according to the sales figure or the number of units sold. We can expect: 1) royalties which vary degressively with the sales level (for example, 6% up to $500,000, 5% between $500,000 and $1,000,000, 4% between 1 and 2 million dollars, etc.); 2) fixed royalties for each year (for example $50,000) or royalties that increase with the years ($50,000 the first year, $60,000 the second, $70,000 the third, etc.); 3) a minimum payment (for example $50,000) that can be increased if the sales figure is sufficient; 4) a maximum payment, the percentage system being discontinued after the sales figure has reached a certain level. Some licensors waive their royalties the first year in order to help the licensee or buyer introduce his product.

On an average, the rate of royalties varies between 5% and 6% for exclusive licenses; it can increase up to 10% in certain high-technology industries (electronics, chemistry, etc.) if the discovery is really revolutionary, and to 15% in the pharmaceutical field; however, it can drop down to 3% in the very competitive traditional industries (clothing, furniture, etc.). In cases of licensing of one or several patents, the royalty is smaller, especially if the license is non-exclusive.

Supplementary payments

This provision is included in cases where the licensee does not reach a minimum sales figure; the licensor then demands a compensation for the commercial damage he underwent due to the licensee's negligence in the manufacturing or marketing. A clause providing for the cancellation of the contract is often added if the situation persists in the following years, to allow the licensor to seek a more competent associate. However, such clauses are only permitted in cases of licensing of industrial property rights.

Payments for services supplied by the licensor or for technical assistance

The agreement often stipulates that the personnel supplied by the licensor to help the licensee or buyer should be paid by the latters. Other costs, such as legal costs, remuneration of the intermediaries, reproduction costs, transportation costs and custom duties in cases of shipment of samples, are often borne by the licensee or buyer.

It is important to specify these terms right from the beginning in order to avoid misunderstandings.

Other costs

The licensee must sometimes assume the filing and renewal expenses of patents in his country. The Canadian Government imposes a tax deduction at source, which varies with the countries where the payments are made by the licensee.

Since January 1st, 1976, the settlement rate, on a general basis, is 25% of taxable amounts, unless it is reduced under a double taxation agreement. Therefore, according to tax agreements in force since April 1982, the rates are the following:

West Germany	**15 to 25%** (according to the type of license)
Australia	**10%**
Belgium	**10%**
United States	**15%**
France	**10 to 25%**
Japan	**15%**
United Kingdom	**10%**
Switzerland	**10%**

For further information, please refer to the circular H76-12R2 published by Revenue Canada, Taxation.

B. OTHER FORMS OF PAYMENT

Acquisition

If the contract requires considerable disbursements and that the licensee or buyer is unable to assume them and invest in the manufacturing and marketing of the product, he can arrange with the licensor to acquire an interest in the capital.

In some instances, the licensor requires such an acquisition in order to control the licensee's exploitation policies and the technical quality of the product, especially where a trademark license is concerned. This method has a great deal of advantages, especially short-term ones, but the buyer must be

careful not to loose control of his company, particularly if the licensor is stronger. Therefore, the buyer must study carefully the advantages and disadvantages of an interest in comparison with an association.

Cross licensing and exchange of techniques

This practice is current among large companies who hold portfolios of patents and technical knowledge. It can also be applied to medium-size companies. Although this method reduces the flow of funds, the main problem lies in the assessment of exchanged patents and techniques, and in the estimation of reasonable compensations.

C. OTHER TERMS OF PAYMENT

After this brief overview, it is rather difficult to choose the most profitable method. A study conducted by the Conference Board[5] with 191 American companies, which is reproduced in the table below, reveals that the majority of agreements combine different kinds of remunerations.

Payment of royalties according to production, sales or any other criterion	97.9%
Technical assistance expenses	69.6%
Profits from the sale of goods or raw material to the licensee	66.0%
Initial payment for the transfer of the technology and the license	59.7%
Dividends on the capital held in the licensed company	56.0%
Retroactive information on licenses and technology transferred	49.2%
Cross licensing and exchange of techniques on the basis of a payment through royalties	43.5%
Expenses for construction or engineering services	40.3%
Increase of the number of shares by retention of the dividends	39.8%
Acquisition of the capital	38.7%
Sale of machinery and equipment to the licensee	37.2%
Exportation of products not covered by the contract so that the buyer can ensure the distribution	35.6%

5. Conference Board, "Appraising Foreign Licensing Performance", 1969, p. 52.

Profits made by the purchase and resale of goods produced by the buyer	26.7%
Management expenses	24.1%
Miscellaneous commissions	16.8%

The terms can thus vary considerably. For example, if the buyer does not have the necessary raw material or equipment, he may have to get them from the licensor. Furthermore, the licensor is sometimes interested in repurchasing a portion or the entire production. This is how large North American companies signed agreements with developing countries where labour is cheap; the parts necessary to the assembling of some finished products (electronics, motors, etc.) are manufactured there and imported by the licensor afterwards.

Another provision concerns improvements made by the buyer or the licensor to the technology which is the subject of the contract. They can be transferred first to the other party under financial terms if they are significant, or free of charge if they are only minor adjustments.

When a license contract is signed, the buyer's rights are generally limited by the licensor. The restrictive clauses, if any, are numerous; we shall mention just a few: agreement to fix or maintain prices, sales restrictions to a territory, fixing the maximum quota for production or sales, exportation restrictions, obligation to purchase some of the licensor's products, etc.

We can notice that the terms are just within the limits of the law because they have a cartel aspect which is not accepted everywhere, especially in countries who have an antitrust law. The buyer must always ensure that the contemplated practices are legal. Each case is different: a practice can be legal in a given situation and illegal in another (for example, if the parties already have an important part of the market).

5. THE COMPULSORY LICENSE — INVENTIONS OF INTEREST TO THE NATIONAL DEFENCE

The concept of compulsory license can be found in practically all legislations. We will now try to explain it by referring to the Canadian Patent Act [section 41 (paragraphs 3 and 4), 67 and 68].

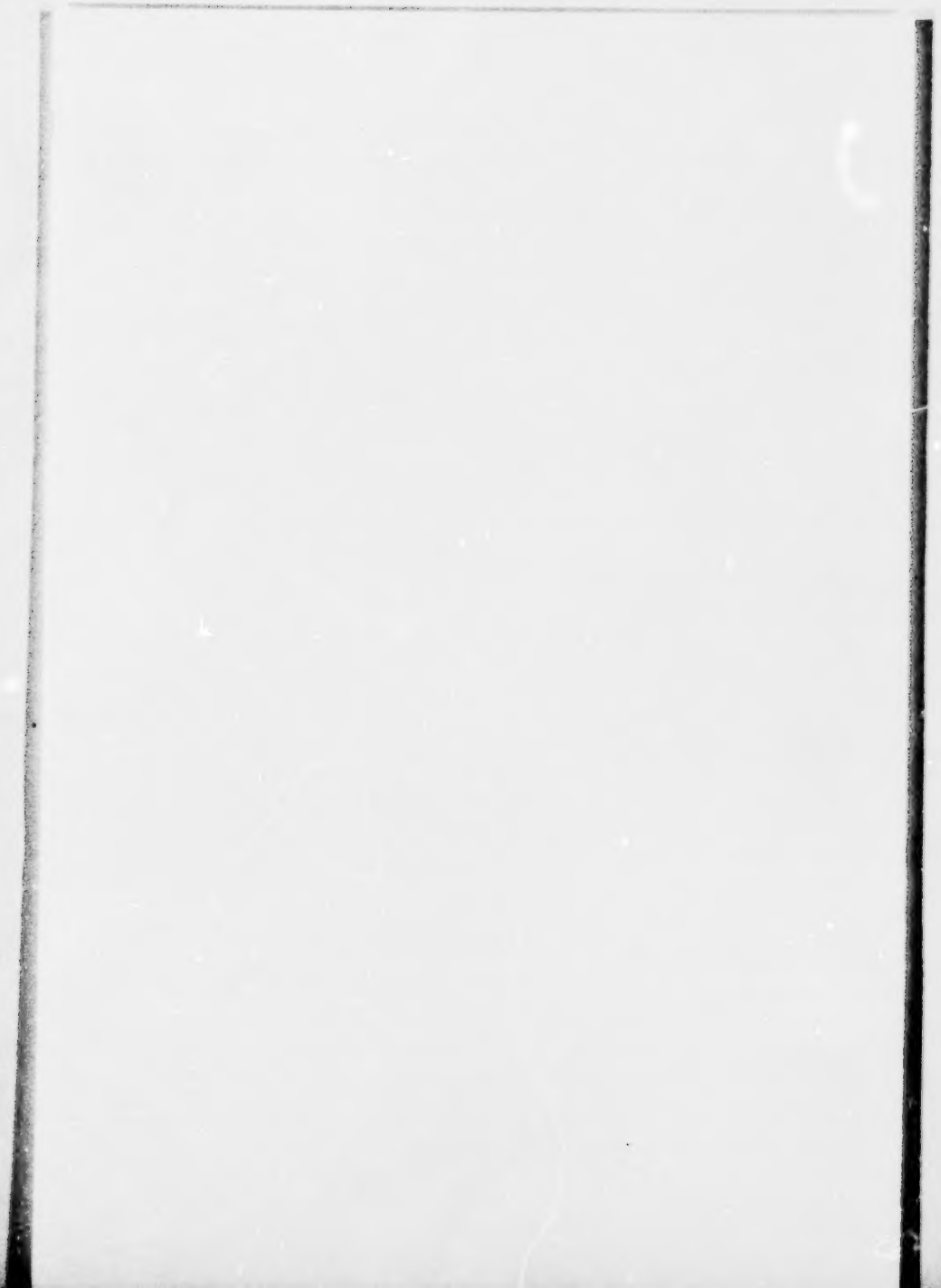
It is possible to make licensing compulsory. In summary, the law says that there is abuse if the licensor or patentee, taking advantage of the monopoly of exploitation granted by the law, is detrimental (as for the quantity, quality or price of the patented products) to anyone exploiting a business or

industry in Canada and even, in some cases, to the public in general. If the applicant succeeds in proving to the Court that such a prejudice has taken place, the licensee may be forced to grant him a license under such conditions as will be deemed fair by the Judge.

This process has been applied mainly in the field of pharmaceutical products, because of the practically total lack of research laboratories in Canada. The Canadian Government estimated that the companies abused their rights and were detrimental to the consumers by fixing exceedingly high prices.

Nevertheless, the compulsory license remains an extremely rare form of licensing: however, we must be aware of its existence to avoid committing a statutory offence by signing a restricted agreement in terms of market, quantity and prices.

The Government may at all times use a patented invention by paying the patentee reasonable royalties (section 19); moreover, if an inventor has made a discovery which is of interest to the Department of National Defence (weapons, communications, etc.), a process of secret patent (section 20) was develop to allow the Government to take over the invention for a certain compensation, while keeping it secret.



CHAPTER

3 LEGAL ASPECTS OF CONTRACTS

It is impossible to present here a model contract since every agreement is a special case. Instead we are offering an "aide-mémoire"; it will be necessary to add or remove some provisions according to the circumstances. We strongly advise you to seek the services of a specialized lawyer to draw up the contract.

AIDE-MÉMOIRE

1. DEFINITION OF TERMS

It is essential to define the terms which are the subject of the contract; they can vary considerably with the contract and the products. A number of them have already been defined at the beginning of this document. Here are a few others:

- licensed products or processes, licensed patents;
- patent, trademark;
- non patented know-how;
- technical assistance;
- patentee, licensee;
- royalties on gross sales or net sales;
- countries or territories concerned.

2. IDENTIFICATION OF THE PARTIES

The following must be specified:

- name, firm name and nationalities of the licensee and patentee;
- addresses of head offices;
- capital, type of company and incorporation date;
- names of company representatives;
- powers of the parties.

3. SUBJECT OF THE CONTRACT

Here are the important items that must be defined:

- the nature of the negotiated rights (patent, patent application, trademark, know-how, etc.);
- the nature of licensing (exclusive, non-exclusive, sole, plain);
- the possibilities of sublicensing and subcontracting;

- use of know-how and trademarks;
- rights to manufacture and sell.

It is essential to give the numbers of patents and patent applications in progress.

4. CHANGE IN THE SITUATION OF ONE PARTY

The disappearance of one of the parties or the repurchase of the companies by a third party must be anticipated and guarantees must be established.

5. GOVERNING LAW

The validity of the contract depends on the law of the countries where the aforesaid contract will be exploited. It is important to specify which law will govern the contract in order to facilitate procedures in case of litigation. Indeed, despite the existence of international agreements, legislations are sometimes contradictory and provisions which are acceptable to the seller may be illegal for the buyer.

6. LANGUAGE OF OFFICIAL TEXTS

Will there be an official translation of the text? In case of a conflict, which text will prevail? It is important to emphasize the difficulty of obtaining good translations of technical documents, which results in serious interpretation conflicts. In all cases, the official language that prevails must be specified.

7. ARBITRATION

In which cases will arbitration be authorized? Who will be the arbitrators (national or international organizations?) and how many of them? Which rules of procedure will be applied? Will the arbitrators' decisions be final? If not, which Court will be competent? In all possible cases, refer to the rules of conciliation and arbitration of the International Chamber of Commerce (I.C.C.).

8. COMPETENT COURTS IN LITIGATION CASES

Parties can stipulate which Court will be competent in a country for a specific litigation. However, some patent or trademark laws are very restrictive on this subject and it may be impossible to choose the competent Court.

9. RIGHTS GRANTED TO THE LICENSEE

A. Exclusivity

Following must be known:

- if the license excludes the licensor;
- if it excludes third parties, except for the licensor;
- if it authorizes the licensor to grant other licenses to third parties under certain conditions (for example, inform the first licensee);
- if it is exclusive for a specific period of time and then non-exclusive.

B. Limitations

Following must be specified:

- if there are no limitations (manufacturing, selling, leasing, using and sub-contracting rights) or if the license applies only to certain countries or territories, to certain applications or industries, to a part of the patent rights.
- if the license is subject to restrictions because of the rights of previous licensees or those of the licensor, or other existing patents belonging to third parties.

C. Sublicense

Is it permitted to grant sublicenses? If so, can they be granted to any third party? Is it necessary to ask for the consent of the licensor or send him a written notice? Are there any other conditions?

10. EFFECTIVE DATE OF THE CONTRACT

Does the contract come into effect on the date it is signed, at a later or earlier date, or when the governmental authorization is granted?

11. DURATION

The parties will determine the duration of the contract according to customary terms. Contracts often stipulate a trial period of two years. At the end of that period, the parties renegotiate the terms of the contract for a specified period of time, based on the results obtained and anticipated.

12. PREMATURE TERMINATION OF THE CONTRACT

The contract may allow one of the parties to cancel it (provided an advance notice is given) for a valid reason, for example: failure to comply with a financial clause, infringement of the terms of the contract, bankruptcy or repurchase of one of the parties, obsolescence of a patent because of the rapid development of technology. Both parties must be aware of the amount of the compensations they will have to pay in case of a cancellation. They must also decide whether certain rights or commitments may outlive the contract.

13. PAYMENT

The following items must be specified:

- currency used;
- remuneration for the patent and the know-how;
- date and sum of the initial payment;
- date and the sum of the minimum annual payments;
- assessment criterion for royalties (units produced, sales, etc.);
- date of royalty payments;
- penalties imposed if parties do not abide by the terms (cancellation of the contract, lost of exclusivity, compensation, etc.);
- deductibility of minimum and initial payments from royalties;
- guarantees against monetary fluctuations;
- special measures in cases of exchange control;
- governmental guarantees for royalty payments;
- place of payment;
- taxes.

14. INSPECTION OF LICENSEE'S ACCOUNTS

Will such an inspection be forbidden? Or will it be authorized at all times? Or only periodically? At certain hours? By competent persons only (accountant, licensor. . .)? Under other conditions? Must a separate bookkeeping be done?

15. CLAUSE FAVORING THE LICENSEE

This clause allows any licensee to benefit from the most favorable method of payment that could be negotiated later by the licensor concerning the technique in question, provided that the other terms of the contract are identical or similar.

It is essential that:

- the licensor advise the licensee of similar licenses he grants;
- the licensee be free to either accept or refuse these new clauses;
- the territory, financial conditions and other terms of the agreement be defined;
- the licensee's situation be dealt with in cases of compulsory licenses or licenses granted to counterfeiters.

16. OBLIGATION TO EXPLOIT LICENSED PATENTS

The licensor can demand that such a clause be included in the contract in order to protect himself against the risk of a compulsory license for non exploitation. It is a question of defining clauses that provide an incentive towards the commitment to exploit, in other words:

- a minimum in sales, output, business investments, advertising expenses and technical investments;
- the sums to be attributed to research;
- the delays in marketing;
- the minimum royalties.

17. IMPROVEMENTS

It is a matter of assessing whether the improvements made by the seller or the buyer must be disclosed or not to the other party and according to which conditions.

Is the licensor obliged to disclose to the buyer his own improvements and those made by third parties or other licensees? Will this information be disclosed for free or for a charge?

Is the licensee obliged to inform the licensor of improvements that were made on the product or process by himself, sublicensees or third parties? Will this information be given free of charge or for a fee?

Does this kind of information have to be revealed to all licensees or only to some of them? will the disclosure be valid in all countries? Who will notify the other parties?

Periodic meetings can be planned between the licensor and the licensees.

18. TECHNICAL ASSISTANCE

Clauses leading with technical assistance can be included in the contract or be the subject of a separate contract.

Following information must be given:

- which documents, plans and diagrams are being submitted;
- the number of engineers, technicians and experts at the disposal of the licensee as well as the duration and place of their stay;
- whether the licensee has access to the licensor's technical facilities;
- which other forms of assistance are being provided during the initial stage and the subsequent ones;
- who pays the technical assistance expenses and under which terms (tariffs, travel and lodging expenses, personal expenditures, etc.).

19. EXCHANGE OF INFORMATION

Exchange of technical, scientific or commercial information can be provided for along with terms to be determined and modes of payment.

20. FILING AND MAINTAINING PATENTS

Will the annuities be paid by the licensee or the licensor? Who will file an application and renew the patents covering the improvements? Who will file an application for a patent in a new country? What will be the terms of discontinuance?

21. VALIDITY OF LICENSED PATENTS

Compensations must be provided for in cases of cancellation of one or several licensed patents. The parties must know who will defend the patents in Court and who will pay the related expenses. What will happen to the other terms of the contract (for example the royalties) in cases where the patent is found invalid.

22. COUNTERFEITING

It is possible to provide for settlement terms in cases of counterfeiting before the signature of the contract. If the patent has been copied by third parties, the contract must stipulate who will be responsible for starting the proceedings and who will bear the expenses. If compensations are obtained following these steps, the distribution method must be defined. Penalties could also be imposed in cases where one of the parties refuses to take action against the counterfeiter.

If the counterfeiting is done on patents belonging to third parties, will the licensor pay the licensee a compensation? Who will be responsible for the defence and the expenses? What will happen if an agreement with third parties becomes necessary because their rights have been counterfeited?

23. SECRECY CLAUSE

Know-how and technical knowledge will always be the subject of a secrecy clause. The information that must not be disclosed must be clearly defined. The duration of this clause must be specified as well as the conditions under which it can be eliminated (for example, if the information becomes known to the public); it is also required to determine the effects the cancellation would have on the rest of the contract (cancellation, reduction in royalties, damages, etc.). If the know-how becomes public property, the licensee will obviously have the right to use it when the contract is terminated.

24. DIVISIBILITY OR INDIVISIBILITY OF THE CONTRACT

The contract must cover the consequences of the illegality of an essential or nonessential provision.

25. ACT OF GOD

Which party can evoke an act of God? What does it mean (cataclysm, unpredictable and serious event, etc.)? What happens then to the contract (suspension, immediate or differed cancellation)?

26. SITUATION AFTER TERMINATION OF THE CONTRACT

What happens to the technical knowledge acquired by the licensee (secret or usage rights); to stocks in his possession (must he hand them over to the licensor, or can he sell them?); to improvements made by each party; to used trademarks; to sublicenses?

27. CORRESPONDENCE

The names, functions and addresses of the persons responsible for the correspondence must be specified.

28. DATE, SIGNATURE AND WITNESSES

Transfer of know-how

When a contract concerns transfer of know-how, it is important to define clearly what the parties mean by the term: drawings, photographies, factory testing reports, laboratory tests, production diagrams, accurate technical specifications on the necessary environment, market studies, promotion methods, lists of customers, etc.

It will also be essential to know what the parties will do if they acquire new knowledge that can improve their know-how or if there is disclosure of confidential information by third parties (whether the parties are at fault or not). Finally, it is necessary to establish if this know-how is secret and which employees must submit to this clause.

CHAPTER

4 THE MINISTÈRE DU COMMERCE EXTÉRIEUR

As mentioned previously, the ministère du Commerce extérieur helps Québec businessmen reach as industrial agreements. Their experts are mandated to:

- provide information on the procedure to follow in seeking industrial agreements;
- provide information on financial and technical assistance available in all stages of the negociation of an agreement;
- promote exchanges between Québec firms and foreign manufacturers or agencies;
- provide information on supply and demand through a data bank which matches foreign and Québec proposals;
- assess business opportunities in relation to domestic and foreign markets.

Financial and technical assistance is also available to promote participation in exhibitions outside the province or travelling abroad in order to negotiate an industrial agreement.

The ministère du Commerce extérieur can help you through its financial advisers posted in 16 cities and nine countries in North and South America, Europe and Asia. These representatives are waiting for any business opportunities liable to be of interest to Québec businessmen.

All these trade agents form the main components of a network which permits the efficient matching of supply and demand in the field of industrial agreements.

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